

1 ARIZONA DEPARTMENT OF FINANCIAL INSTITUTIONS

2 In the Matter of the Escrow Agent License of:

3 **FIRST FINANCIAL TITLE AGENCY OF**  
4 **ARIZONA AND TOM E. PASCHEN, PRESIDENT**  
5 2222 East Camelback Road, Suite 200  
Phoenix, Arizona 85016

No. 06F-BD013-BNK

**SUPERINTENDENT'S FINAL  
DECISION AND ORDER**

6 Respondents.  
7

8 The Superintendent of Financial Institutions (the "Superintendent") having reviewed the record  
9 in this matter, including the Recommended Decision of the Administrative Law Judge attached and  
10 incorporated herein by this reference, adopts in part and modifies in part the Administrative Law  
11 Judge's Findings of Fact, Conclusions of Law and Recommended Order as follows.

12 **FINDINGS OF FACT**

13 The Superintendent adopts the Administrative Law Judge's Findings of Fact paragraphs 1- 26 and 28 -  
14 42.

15 The Superintendent modifies paragraph 27 for the reason that the examination costs and  
16 balance owing, stated as "approximate," are "actual." (Transcript of Hearing, Volume II, pp.372-373.)

17 Modified paragraph 27 shall state:

18 27. The Department's official cost for the examination by Carpenter, Moss and others was  
19 \$33,300.00 of which \$10,000.00 has been paid, leaving a balance of \$23,300.00 owing.

20 **CONCLUSIONS OF LAW**

21 The Superintendent adopts the Administrative Law Judge's Conclusions of Law paragraphs 1-8  
22 including the introductory paragraph.

23 The Superintendent modifies the Conclusions of Law by adding new paragraph 9 for the reason  
24 that the Superintendent has the authority to assess examination and penalty fees (A.R.S. §§ 6-125 B  
25 and 6-125 D).

26 New paragraph 9 shall state:

27 The Superintendent has the authority to assess examination and penalty fees pursuant to A.R.S.  
28 §§ 6-125 B and 6-125 D. Penalty fees accrue at \$50.00 per day after the thirty-day period that

1 the financial institution or enterprise fails to remit the assessment unless a written extension is  
2 approved by the Superintendent. In no event shall the total penalty exceed the examination  
3 assessment. Penalty fees started accruing on October 18, 2005, the day after the assessment due  
4 date.

5 **ORDER**

6 IT IS ORDERED that the Respondent's escrow agent license be revoked.

7 IT IS FURTHER ORDERED that the Respondent pay a civil money penalty of Twenty  
8 Thousand (\$20,000.00) Dollars.

9 IT IS FURTHER ORDERED that Respondent's President Tom Paschen pay a penalty of Ten  
10 Thousand (\$10,000.00) Dollars.

11 IT IS FURTHERED ORDERED that Respondent pay the remaining examination fee of \$23,  
12 330.00 and \$50.00 a day late penalty payment not to exceed the examination assessment (calculated  
13 from the date of October 18, 2005), until the examination fee is paid. The civil money penalties,  
14 examination fee and late penalties shall be paid in full within 60 days of the effective date of this  
15 Order.

16 **NOTICE**

17 The parties are advised that, pursuant to A.R.S. § 41-1092.09, this Order shall be final unless  
18 Respondents submit a written motion for rehearing or review no later than thirty (30) days after service  
19 of this decision. The motion for rehearing or review must specify the particular grounds upon which it  
20 is based as set forth in A.A.C. R20-4-1219. A copy shall be served upon all other parties to the  
21 hearing, including the Attorney General, if the Attorney General is not the party filing the claim of  
22 error. In the alternative, the parties may seek judicial review of this decision pursuant to A.R.S. §§41-  
23 1092.08(H) and 12-901 *et seq.*

24 DATED this 14<sup>th</sup> day of April, 2006.

25  
26 

27 Bruce Tunell  
28 Acting Superintendent of Financial Institutions<sup>1</sup>

<sup>1</sup> The Superintendent has recused herself from this matter and, therefore, Bruce Tunell is serving as the Acting Superintendent.

1 ORIGINAL filed this 14<sup>th</sup> day of  
2 April, 2006, in the office of:

3 Felecia Rotellini  
4 Superintendent of Financial Institutions  
5 Arizona Department of Financial Institutions  
6 ATTN: June Beckwith  
7 2910 North 44th Street, Suite 310  
8 Phoenix, Arizona 85018

9 COPY of the foregoing mailed/hand delivered  
10 This same date to:

11 Allen Reed, Administrative Law Judge  
12 Office of Administrative Hearings  
13 1400 West Washington, Suite 101  
14 Phoenix, AZ 85007

15 Craig A. Raby, Assistant Attorney General  
16 Office of the Attorney General  
17 1275 West Washington  
18 Phoenix, AZ 85007

19 Victoria Mangiapane, Assistant Attorney General  
20 Office of the Attorney General  
21 1275 West Washington  
22 Phoenix, Arizona 85007

23 Robert D. Charlton, Assistant Superintendent  
24 Arizona Department of Financial Institutions  
25 2910 N. 44th Street, Suite 310  
26 Phoenix, AZ 85018

27 AND COPY MAILED SAME DATE by  
28 Certified Mail, Return Receipt Requested, to:

29 Tom E. Paschen  
30 President  
31 First Financial Title Agency of Arizona, Inc.  
32 2222 E. Camelback Road, Suite 200  
33 Phoenix, AZ 85016

34 Robert P. Lindfors, Esq.  
35 Carson Messingr Elliott Laughlin & Ragan, P.L.L.C.  
36 3300 North Central Avenue, Suite 1900  
37 Phoenix, Arizona, 85012  
38 Attorneys for Respondents

39 BY: June Beckwith

IN THE OFFICE OF ADMINISTRATIVE HEARINGS

In The Matter Of the Escrow Agency  
License of:

No. 06F-BD013-BNK

ADMINISTRATIVE LAW JUDGE  
DECISION

FIRST FINANCIAL TITLE AGENCY OF  
ARIZONA AND  
TOM E. PASCHEN, PRESIDENT  
2222 East Camelback Road, Suite 200  
Phoenix, Arizona 85016

**HEARING:** November 22, 2005 and January 26 and 27, 2006

**APPEARANCES:** Craig Raby, Assistant Attorney General, appeared on behalf  
of the Department.

Robert Lindfors, Esq. appeared on behalf of the Respondent

**ADMINISTRATIVE LAW JUDGE:** Allen Reed

**Findings of Fact**

1. The essential facts of this case are relatively straightforward and not subject to significant dispute.
2. There are two major issues in this case. In general terms they are the failure to comply with certain escrow requirements<sup>1</sup> and the negative position of the Respondent's financial condition.
3. In addition to imposing sanctions against the licensed entity, the Arizona Department of Financial Institutions<sup>2</sup> (Department) is also seeking a \$50,000.00 penalty against the Respondent's president, Tom Paschen (Paschen).
4. The Respondent holds an escrow agent license issued by the Department<sup>3</sup>.
5. The instant case concerns 16 audited transactions which are the basis for the alleged violations.

<sup>1</sup> The requirements as presented by the Department are failure to protect and safeguard the property of the public, lack of internal controls, and failure to follow HUD 1 settlement statements.

<sup>2</sup> Formerly the Arizona State Banking Department

<sup>3</sup> As of the conclusion of the hearing, the business has been sold.

- 1 6. Victoria Cervantes (Cervantes), and Herman Joel Montemayor (Montemayor),  
2 are husband and wife. They worked for Respondent as escrow agents during a  
3 period in 2002 to 2003. Carmen Cantu (Cantu), and Betty Barbee (Barbee), are  
4 husband and wife, and were Arizona realtors. Barbee is Montemayor's aunt.
- 5 7. Richard Carpenter (Carpenter), Department examiner, began an examination<sup>4</sup> of  
6 the Respondent in February 28, 2005. The examination began with 880 of the  
7 Respondent's escrow accounts. Of the 880 accounts, Carpenter focused on 78  
8 which involved Cervantes, Montemayor, Cantu, and Barbee<sup>5</sup>. The examination  
9 ended in April, 2005.
- 10 8. A HUD -1 is the basic escrow document for an escrow transaction. According to  
11 Carpenter, it should accurately reflect the financial reality of the transaction.
- 12 9. Exhibit 6A (1-15 were admitted). It shows the initial account examined By  
13 Carpenter. This was with Mary S. Salas (Salas), as seller<sup>6</sup> and Arthur M. Morales  
14 (Morales), as buyer. This is the transaction which initiated the investigation.  
15 Cervantes was the escrow officer. The Hud-1 shows a disbursement of  
16 \$31,183.50 <sup>7</sup> to the seller and \$500.00 for Escrow Hold Back. In fact, the checks  
17 in those amounts went to Barbee <sup>8</sup>. \$67,545.98 in what appears to be legitimate  
18 mortgage and related foreclosure costs, was also disbursed and its payment  
19 cancelled a Foreclosure Sale. Over \$8,000.00 from the sale proceeds was used  
20 to pay judgments for the benefit of Salas. The named buyer and borrower,  
21 Morales, was identified as the minor son (approximately 10 or 11 years old at the  
22 time)<sup>9</sup>, of Cervantes who had notarized the signature of that name and the Salas

23 <sup>4</sup> The examination was undertaken because of a complaint to the Arizona Department of Real Estate by a  
24 seller of property (Maria Salas). The Respondent was the escrow agent.

25 <sup>5</sup> Another party was also involved. He was identified as Francisco Martinez who worked for the mortgage  
26 lender in most of the transactions.

27 <sup>6</sup> According to a report of an interview with Salas, she claimed that she never sold the property. Evidence  
28 suggests Salas discussed the possibility of selling the property with Cantu and receiving \$10,000.00 after  
29 payment was made to avoid foreclosure. Cervantes' notarizations of documents with the signatures of  
30 Salas and Morales were knowingly false based on the preponderance of the credible evidence.

<sup>7</sup> Money which should have gone to Salas but went to Barbee. Salas was subsequently evicted from her  
home.

<sup>8</sup> A handwritten note by the Respondent on the HUD-1 shows the checks went to Barbee. Exhibit 6a (4) is  
an instruction (purportedly from Salas but based on the evidence, most likely falsified), that the proceeds  
of the sale were to go to Barbee.

<sup>9</sup> False documentation listed Morales' date of birth as January 18, 1970.

1 name on the Deed of Trust (Exhibit 6a (10)).<sup>10</sup> The Customer Identification  
2 Verification form (Exhibit 6a (9)) was incomplete when it should have been  
3 completed.<sup>11</sup> Considering the evidence of this transaction, Cervantes as a  
4 principal in a fraudulent transaction, notarized documents knowing the  
5 documents and signatures to be false, used her son as a fictitious buyer, was  
6 knowingly a party to the fraudulent sale of property, fraudulently obtained funds  
7 for the property, and had over \$31,000.00 of the fraudulently obtained proceeds  
8 transferred to Barbee. The above are not intended to be a complete detailed  
9 listing of Cervantes' wrongful acts.<sup>12</sup>

10 10. Exhibit 6K (1-15 were admitted). This transaction concerns Jerry Arredondo  
11 (Arredondo), as seller and Mayara Diaz (Diaz), as the buyer. Cervantes closed  
12 the transaction. The evidence shows a check of \$4,360.00 to Cantu as part of a  
13 joint venture agreement but neither the joint venture agreement nor the amount  
14 are specifically reflected in the HUD-1 document.<sup>13</sup>

15 11. Exhibit 6L (1-4 were admitted).<sup>14</sup> Montemayor was the escrow officer for the  
16 transaction. Cantu was the recipient of \$5,000.00 from the transaction but this  
17 disbursement was not shown on the HUD-1. This was a refinance transaction  
18 and the \$5,000.00 appears to have come from the borrower's funds. It is  
19 unknown why Cantu a realtor would receive \$5,000.00 on a refinance  
20 transaction.

21 12. Exhibit 6M (1, 2, 3, and 4 were admitted). The exhibits show that fees to  
22 mortgage company were miscalculated (According to Carpenter, the buyer  
23 improperly received the loan origination fee). This was categorized as a mistake  
24 by the Department's counsel rather than conscious wrongdoing.

25 <sup>10</sup> Morales, the created buyer, had the same name and social security number as Cervantes' son.  
26 Cervantes did not acknowledge to the investigators who subsequently interviewed her that the presumed  
27 fictitious buyer was her son. She has however, pled guilty to Forgery in connection with the Salas matter.

28 <sup>11</sup> The form requests information on the borrower-buyer (Morales)

29 <sup>12</sup> It is understood that any findings of fact with respect to Cervantes, Montemayor, Cantu, and Barbee are  
30 solely for the purpose of submitting a recommended decision in the instant case. Except for criminal  
convictions of record sustained by participants related to and based on the particulars of this case, such  
findings cannot have any legal applicability with respect to the named individuals and related matters  
which may be pending or may arise.

<sup>13</sup> The amount appears to have come from the "cash to seller" amount.

<sup>14</sup> Additional 6L exhibits (5-10) were not specifically referenced.

- 1 13. Department witness Judi Moss (Moss), Senior Financial Institution Examiner,  
2 testified concerning Exhibit 6C (1, 2, 3, 5, and 7 were admitted). The exhibits  
3 show Cervantes as the escrow officer. Cantu received a \$5,000.00 check on this  
4 transaction although the sale was listed as "FSBO" (For Sale By Owner). There  
5 was no documentation in the file to show Cantu was entitled to payment. Moss  
6 also testified there was a HUD-1 error in this transaction and loan funds were  
7 \$449.00 short.
- 8 14. Moss testified about Exhibit 6D (1-7 were admitted). Cervantes was the escrow  
9 officer. The Disbursement Report shows disbursement of \$483.39 to Barbee  
10 without proper documentation authorizing the disbursement.
- 11 15. Moss testified about Exhibit 6E (1-15 were admitted). The exhibit shows that  
12 Cervantes was the escrow officer and there was a distribution of \$3,512.00 to  
13 Cantu when there is no indication in the HUD-1 that the payment was authorized.  
14 In addition there is a \$100.00 error in payment to the borrower and an additional  
15 approximately \$3,700.00 shortage to the seller.<sup>15</sup>
- 16 16. Moss testified about Exhibit 6F (1-11 were admitted). It shows inconsistencies of  
17 \$2,960.00<sup>16</sup> in the HUD-1 and receipts and disbursements journal. Montemayor  
18 was the escrow officer.
- 19 17. Moss testified about Exhibit 6G ( 2, 3, 4, 6, 8, 9, 10, 11, 12 were admitted).  
20 \$6,000.00 was disbursed to Cantu without authorization or being reflected on the  
21 HUD-1. The payment was reflected in the Disbursement Report. Montemayor  
22 was the escrow officer. According to Moss this account showed it still had an  
23 unexplained escrow balance of \$3,750.00.
- 24 18. Moss testified about Exhibit 6H ( 1, 2, 8 ). Nothing was cited as being improper  
25 with this transaction.
- 26 19. Moss testified about Exhibit 6I (1, 2, 3, 6, 7, 8, 9, 10, 11, 19 ). According to Moss  
27 the HUD-1 shows that the amount of \$26,033.90 was disbursed to Cantu and  
28 \$90,000.00 to a person named Antonio Alvarez, without appropriate

29 <sup>15</sup> This is in addition to the disbursement to Cantu. The exact reason for this inconsistency was not  
30 established.

<sup>16</sup> Paid to Cantu but not authorized according to Moss

documentation authorizing the disbursement. Cervantes was the escrow officer. She also notarized the deed of trust.

20. Moss testified about Exhibit 6J (1-6 were admitted ). Moss testified that in looking at the HUD-1, nothing shows that a payment to Cantu in the amount of \$2,267.90, was authorized.

21. Robert Rivera (Rivera) is a special agent for the Arizona Attorney General's office. In December of 2004, he was contacted by an investigator with the Arizona Department of Real Estate and became involved in the Cervantes, Montemayor, Cantu and Barbee investigation. The investigation was initiated by the previously referenced Salas complaint. Rivera interviewed Cervantes who made no admission of wrongdoing. Rivera essentially confirmed information set forth in Finding of Fact paragraph 9 of this Recommended Decision. Rivera also outlined the nature of the activity engaged in by the named principals. They essentially created buyers with fictitious identities, Cantu-Barbee as realtors would set up the sale, Cervantes-Montemayor as escrow officers would process the transaction, Martinez, the loan officer arranged for financing<sup>17</sup>.

22. According to Exhibit 4, eleven of the transactions reviewed by Rivera involved seven minors with false information as named buyers. Cervantes was the escrow officer on eight of the eleven transactions and the amount of money misappropriated was \$141,098.00.

23. Cervantes eventually entered into a plea agreement wherein she pled guilty to Forgery (a felony) in the Salas matter. She was sentenced to three months incarceration and probation (an order for restitution to Salas had not been entered at the conclusion of the instant case). Barbee, Cantu and Martinez (the loan officer), also entered pleas to felonies related to the one or more of the transactions in the instant case.<sup>18</sup>

24. Exhibit 10 shows that for the year ending December 31, 2003, stockholder equity in the Respondent was \$340,129.00. By end of 2004, the equity was negative

<sup>17</sup> This is not to say all transactions were exactly the same. This was the general framework of the scheme.

<sup>18</sup> The specific details of the pleas are not essential to a determination of this case.



1 \$60,932. The net income for fiscal year ending (FYE) 2003 was \$531,807.00 and  
2 for FYE 2004 it was a net loss of \$251,061.00, with an operating loss of  
3 \$417,500.00 on gross revenues of \$9,083,000.00.

4 25. Exhibit 11 shows that the Respondent's shareholders' equity fell to a negative  
5 \$831,729.00 with the net losses for the Respondent for the first six months of  
6 2005 at \$770,796.00 added to the previous negative equity figure. Revenue  
7 figures have also fallen for over 50% in a year.

8 26. The Financial Services Division of the Department issued a Report of  
9 Examination on August 29, 2005 and the Deputy Superintendent issued a  
10 Cease and Desist Order to the Respondent on September 2, 2005. The Order  
11 also assessed a \$50,000.00 penalty.

12 27. The Department's official cost for the examination by Carpenter, Moss and  
13 others was Approximately \$33,300.00 of which \$10,000.00 has been paid  
14 leaving a balance of approximately \$23,300.00 owing.<sup>19</sup>

15 28. Robert Charlton, Assistant Superintendent for the Department testified that the  
16 scope and extent of the of the undetected fraudulent activity by Cervantes was  
17 such that it shows the Respondent had insufficient internal controls. No specifics  
18 of what sufficient internal controls would protect against fraud were presented  
19 except that the Respondent did not have them in light of the number of  
20 transactions handled by Cervantes or Montemayor which transactions were  
21 fraudulently and improperly handled. The argument has a potential for being  
22 circular (if an undetected fraud is perpetrated by a rogue employee, the controls  
23 are *ipso facto* inadequate), but it is recognized that it is difficult to establish bright  
24 line standards which would objectively show what constitutes adequate internal  
25 controls in the face of criminal and fraudulent conduct by an employee. Charlton  
26 also testified that in addition to revocation of the license, a civil penalty should be  
27 assessed against the Respondent and Paschen in order to send a message to  
28 the industry.<sup>20</sup>

29 <sup>19</sup> The amounts as testified to by Robert Charlton were not challenged.

30 <sup>20</sup> It is understood that the Department has an important duty to rigorously protect the public with respect  
to the potential harm which can be done in these types of transactions. The need for trust, competency,  
and accuracy is essential when dealing with what for most people is their most expensive financial asset.

1 29. Charlton testified concerning the Report of Examination dated August 2, 2005  
2 (Exhibit 2). The exhibit was submitted as *prima facie* proof of the facts asserted  
3 therein under A.R.S. §6-129(D). The Report required that the Respondent  
4 provide additional cash infusion to "stem the rapid erosion of equity capital...to  
5 cause the Company's capital net worth to reflect a positive position". In addition  
6 the Examination Report set forth extensive facts which constituted violations of  
7 the applicable banking laws if not rebutted.

8 30. Paschen testified he has been the Respondent's president since 1999. As  
9 president he oversaw the operation of the business, put policies and procedures  
10 in place, hired mid level managers and was also responsible for the financial side  
11 of the business. In 2002 Paschen hired a State Manager with 20 years  
12 experience. The Respondent also had a Senior Escrow Operations Manager, a  
13 Senior Title Operations Manager and Comptroller. Next were individual  
14 department manager (title or escrow managers), branch managers, and finally  
15 escrow officers which numbered approximately 30 at the time<sup>21</sup>. Normally the  
16 escrow branch managers recommended the hiring that needed to be done. The  
17 decision to hire someone would be made by the Senior Escrow Operations  
18 Manager, the branch manager, and the Human Resources Director. Background  
19 checks are routinely done on every escrow officer including Cervantes<sup>22</sup>.

20 31. In 2002, the Respondent purchased another title company (United) with five  
21 branch operations. All but two of the United employees became the  
22 Respondent's employees. The branch managers for Cervantes and Montemayor  
23 had 15 and 10 years experience respectively. The Senior Escrow Operations  
24 Manager had more than 15 years of escrow experience.

25 32. After a probationary period, escrow officers are allowed to sign disbursement  
26 checks which would also have to be signed by the branch manager. A computer  
27 software program required that transactions balance in order to print checks.

28 The question is whether after a sanction which removes a licensee from continuing to do business, the  
29 public purpose is constructively served by imposing a civil penalty in order to send a message to other  
30 licensees. It is acknowledged a civil penalty may be imposed to compensate the agency for the cost of  
the investigation and administrative proceedings as well as a penalty.

<sup>21</sup> The Respondent had approximately 122 employees.

1 Branch managers were required to check the settlement statement for unusual  
2 payments. The operations level would check trial balances<sup>23</sup> out of the  
3 accounting department. The Senior Escrow Operations manager was required to  
4 check random closed files monthly (possibly up to 10%). In 2003 the  
5 Respondent hired an escrow technician to focus on reviewing files and to assist  
6 the Senior Escrow Operations Manager. An outside CPA firm also audited files  
7 on a monthly basis (10% from each branch). A report would be prepared for the  
8 State Manager and the Senior Escrow Operations Manager.

9 33. According to Paschen, Montemayor was terminated by the Respondent  
10 because of improprieties discovered by the CPA firm during one of its audits.  
11 Cervantes was terminated after the discovery of original documents in her desk,  
12 which documents had not been properly recorded. The terminations occurred  
13 before the Salas revelation.

14 34. Paschen testified concerning the Respondent's partnership with another title  
15 company which partnership ended in August or September of 2004. According to  
16 Paschen the other title company "pirated" several of the Respondent's large  
17 branches, and the Respondent's State manager also pirated some branches  
18 after being terminated. Two branches (one dealing primarily with commercial  
19 realty), which left the Respondent had incurred excessive losses due to  
20 miscalculations and failure to pay taxes. The Respondent went from 13 to seven  
21 branches but the cost of the pirated (but vacated), branches remained the  
22 Respondent's costs.

23 35. In early 2005, the Respondent obtained additional investor capital in the amount  
24 of \$400,000.00. Sometime thereafter, the Respondent began looking for a buyer  
25 for the business.

26 36. Based on the results of the Department's examination, the Department issued a  
27 Cease and Desist Order to the Respondent dated September 2, 2005. It  
28

29 <sup>22</sup> The nature and full extent of these checks was not specifically addressed.

30 <sup>23</sup> An accounting report of all files processed that month which would show files where checks had not cleared, wire transfers that were not properly applied, or other potential irregularities appeared to be present. The branch manager was to review the file to determine the nature of any problem and resolve it.

1 asserted numerous violations, required the Respondent to correct those  
2 violations, enter a Consent Agreement, and pay a \$50,000.00 civil penalty.

3 37. The Respondent met with State Banking officials in September and October,  
4 2005 regarding the Respondent's financial condition. The meetings were  
5 concerned with findings of the examination with a focus on the Respondent's  
6 precarious financial condition.

7 38. The Respondent did not enter into the Consent Agreement and the Department  
8 issued a Notice of Hearing on October 18, 2005.

9 39. The Respondent sold the assets of the business December 30, 2005 (the matter  
10 initially came on for hearing in November, 2005) . The sales price was  
11 \$600,000.00 with \$200,000.00 down and the remaining \$400,000.00 to be paid  
12 at \$20,000.00 a month. As a consequence of the sale, the Respondent suffered  
13 a \$250,000.00 loss (shareholder losses are separate).

14 40. As extensive as the fraudulent activities of Cervantes *et al* were, they are  
15 unrelated to the Respondent's financial condition.

16 41. Salas has a suit pending against the Respondent in Maricopa County Superior  
17 Court.

18 42. The Respondent has a \$100,000.00 fidelity bond which is not available to  
19 creditors or the Department.

### 20 **Conclusions of Law**

21 The Notice of Hearing alleges violations of the following statutes and rules:

22 A.R.S. §6-841 which provides in pertinent part that an escrow agent shall adopt  
23 an internal control structure to (A) ensure an employee does not make significant  
24 errors, perpetuate irregularities or fraud without timely detection and (B) internal control  
25 structure means policies and procedures to provide reasonable assurance that the  
26 escrow agent will safeguard customer assets, have reliable financial reporting and  
27 reliable reporting of escrow transactions.;

28 A.R.S. §6-837(A) which provides in pertinent part that an escrow agent shall  
29 produce escrow records for inspection to any state law enforcement agency.

30 Subsection (B) provides in pertinent part that an escrow agent shall produce records  
requested by any state agency lawfully requiring such disclosure;

1 A.R.S. §6-817(A)(7) addresses failing to account properly for escrow property;  
2 A.R.S. §6-817(A)(11) addresses disbursement of monies in violation of escrow  
3 instructions;

4 A.R.S. §6-817(A)(2) addresses violation of applicable law;<sup>24</sup>

5 A.R.S. §6-817(A)(3) addresses a licensee's financial condition is such that it  
6 cannot continue in business with safety to its customers;

7 A.R.S. §6-817(A)(10) addresses the licensee's financial resources and if they are  
8 sufficient to adequately serve the public or warrant the belief that the business will be  
9 operated lawfully, honestly, fairly and efficiently;

10 A.R.S. §6-817(A)(12) addresses the requirement to maintain adequate internal  
11 controls;

12 A.R.S. §6-831 addresses the requirement to keep and maintain records;

13 A.R.S. §6-834 addresses requirements for the deposit of escrow funds and  
14 subsection (A) provides that escrow funds are to be deposited in a separate escrow account  
15 upon receipt;

16 A.R.S. §6-841.01 addresses the fiduciary duty of an escrow agent or employee;

17 A.R.S. §6-817(A)(13) addresses causing or allowing an overdraft or returned  
18 check for insufficient funds on the escrow agent's trust or escrow accounts;

19 A.A.C. R20-4-702 sets forth the minimal information required in records for escrow  
20 transactions;

21 A.A.C. R20-4-703 requires that records be preserved for at least three years  
22 from the settlement date.

23 A.R.S. §6-132 allows in pertinent part for the imposition of a \$5,000.00 penalty  
24 against a person<sup>25</sup> (including an officer or director) for any knowing violation of the  
25 applicable banking law.

26 A.R.S. §1-215(17) provides that "knowingly" imports a knowledge that the facts  
27 exist that bring the act or omission within the provisions of the statute using such word.  
28

29 <sup>24</sup> This cite generally has no practical application because it does not constitute an independent violation  
30 but relies on finding an underlying violation of applicable law.

<sup>25</sup> Person includes a corporation under A.R.S. §1-215

1 A.R.S. §6-129(D) provides that "Every official report of the department is *prima*  
2 *facie* evidence of the facts therein stated in any action or proceeding wherein the  
3 superintendent is a party"

4 A.A.C. R20-4-708 sets forth 11 criteria for the superintendent to consider an  
5 escrow agent's financial condition. The criteria are:

- 6 1. Amount of positive net worth,
- 7 2. Amount of tangible net worth,
- 8 3. Amount of liquid assets,
- 9 4. Amount of cash provided by operations,
- 10 5. Ratio of debt to net worth,
- 11 6. Owner's personal financial resources,
- 12 7. Outside resources available,
- 13 8. Profitability,
- 14 9. Projected operating results,
- 15 10. Status as agent for title insurance company, and
- 16 12. Sources of new business.

17 1. The Department has the burden of proof, and the standard of proof on all  
18 issues is by a preponderance of the evidence. *Culpepper v. State*, 187 Ariz.  
19 431, 930 P.2d 508 (App. 1996). A "preponderance of the evidence is such  
20 proof as convinces the trier of fact that the contention is more probably true  
21 than not." Morris K. Udall, *Arizona Law of Evidence*, §5 (1960). It is  
22 "evidence which is of greater weight or more convincing than the evidence  
23 which is offered in opposition to it; that is, evidence which as a whole shows  
24 that the fact sought to be proved is more probable than not." *Black's Law*  
25 *Dictionary*, 1182 (6<sup>th</sup> ed. 1990).

26 2. The violations alleged in the Notice of Hearing can be divided into two  
27 categories. The first and most serious category concerns those matters that  
28 were the subject of direct testimonial and documentary evidence during the  
29 hearing. This essentially includes all admitted evidence except the  
30 Department's Report of Examination which was not the subject of extensive  
examination due to the statutory *prima facie* provision. The finding of

violations will be separated on this basis with the non A.R.S. §8-129(D) evidence to be considered first.<sup>26</sup>

3. It is the opinion of the Administrative Law Judge that each matter or transaction presented by the Department does not require individual discussion. Rather, in view of the facts presented and established by a preponderance of the substantial evidence, conclusions of violations shall be based on the application of the law to the facts in their entirety unless specific discussion is required.
4. The activities of Cervantes<sup>27</sup> while acting as an employee of the Respondent and with respect to the various transactions in this record for which she was the escrow officer, clearly establish violations of A.R.S. § 6-841.01 (fiduciary duty), §6-817(A)(7) (proper accounting for escrow property), and (A)(11) (disbursal of money in violation of escrow instructions), for which the Respondent is liable under the law.
5. In addition to the Respondent's violations as a consequence of the activities by Cervantes, and based on the evidence, the law, and the legal arguments presented by both sides, it is concluded that the Respondent is directly in violation of A.R.S. §6-841(A) (ensure against errors, irregularities and fraud), §6-817(A)(3) (financial condition is such that a licensee cannot continue in business with safety to customers)<sup>28</sup>, (A)(10) (Respondent's financial resources are such that there is a question of the adequacy to serve the public or to be operated lawfully and efficiently), and (A)(12)(internal controls). The issue of internal controls was discussed in paragraph 28 of the Findings of Fact. Although the violation appears somewhat circular (i.e. internal controls are adequate until they fail), the nature and extent of the Cervantes *et al* activities were such that the Respondent's failure to discover

<sup>26</sup> The asserted A.R.S. §8-129(D) violations appear to be added as an aggravating circumstance and not relied upon for the primary sanctions which the Department is requesting.

<sup>27</sup> The transactions which involve Montemayor show some technical violations but in light of the violation involving Cervantes, do not merit independent discussion.

<sup>28</sup> This is construed to mean not only the customer's financial safety but also among other things, the Respondent's ability to adequately serve the customer, to conduct business accurately, efficiently, without

1 the activities (even after Montemayor and Cervantes had been terminated for  
2 work related errors or misconduct), until after the Salas complaint, is sufficient  
3 to establish the charged violations.

4 6. The Department does not argue, and the facts do not show that Paschen or  
5 persons connected with the Respondent other than those identified in this  
6 Recommended Decision, had any knowledge of the wrongful or unlawful  
7 conduct by Cervantes or Montemayor as the conduct was engaged in. To this  
8 extent, and in light of the definition of "knowingly" Paschen cannot be held  
9 responsible for the violations of Cervantes or Montemayor because he did not  
10 know the facts about what they were doing. Nor can Paschen be subject to a  
11 penalty for violations which are not related to the Respondent's financial  
12 condition.

13 7. The Department relies on the negative financial condition of the Respondent  
14 and Paschen's knowledge of that condition. The Department argued that the  
15 Respondent's negative equity position establishes Paschen's liability under  
16 A.R.S. §6-132. Paschen knew of the Respondent's financial condition was  
17 such that it could not continue in business<sup>29</sup>. In view of the extensive losses the  
18 business incurred, safety to the Respondent's customers was jeopardized and  
19 the licensee's financial resources were not sufficient to adequately serve the  
20 public or warrant the belief that the business will be operated lawfully, honestly,  
21 fairly and efficiently. Paschen saw these problems as early as the fourth  
22 quarter of 2004. Although additional capital was infused in early 2005, the  
23 losses continued and increased without any significant sign of improvement,  
24 effective action to staunch the continuing losses, sale of the business (until the  
25 end of 2005), or otherwise successfully addressing the precarious financial  
26 condition<sup>30</sup>. Unfortunate circumstances encountered by the Respondent may  
27 have contributed to the financial woes. However, those circumstances were

28 a threat of financial collapse, or the need to possibly curtail internal control structures due to financial  
29 pressures or concerns.

30 <sup>29</sup> Deciding to sell the business in early 2005.

<sup>30</sup> In Exhibit 7 dated October 14, 2005, Paschen asserts that Respondent's expenses have been reduced  
by 30% in the past year and that the Respondent made a profit in August, 2005.



1 based on business decisions made by management. Management made the  
2 decision to hire a State Manager who ultimately left and pirated employees, or  
3 to enter into a partnership which dissolved and resulted in more pirating. It is  
4 difficult to accept Paschen's explanation that the Respondent was somehow  
5 unable to protect itself from such activity. Paschen's liability for the violations of  
6 A.R.S. §6-817(A)(3) (Respondent's financial condition and customer safety)  
7 and (A)(10) (Respondent's financial resources are such that there is a  
8 question of the adequacy to serve the public or to be operated lawfully and  
9 efficiently), is established. The conclusion is not easily reached. However, the  
10 fiduciary duty of the Respondent to the public, the serious financial  
11 consequences of the business activity of an escrow agent, the extended  
12 continuing downturn of the Respondent's business, the ever increasing  
13 losses, when coupled with the clear intent of the legislature under the cited  
14 statute<sup>31</sup>, is such that Paschen's liability is proven under the statute.<sup>32</sup>

- 15 8. The Report of Examination (Report) will not be addressed in great detail in  
16 this Recommended Decision. Many of the allegations in the Report duplicate  
17 those which were proven based on the testimonial and non Report evidence  
18 presented at the hearing. The allegation of Failure to Produce Records for  
19 Inspection is not sustained because what is a "reasonable time", is essentially  
20 a legal and not a factual determination, and A.R.S. §6-129(D) does not apply  
21 to legal conclusions. Limited conclusions under A.R.S. 6-129(D) are based on  
22 the facts that the Respondent had missing files which would constitute  
23 violations of A.R.S. §6-831 and A.A.C. R20-4-702 and 703 relating to  
24 retaining and maintaining adequate records of transactions<sup>33</sup>. The alleged  
25 failure to adequately document certification of each bank account

26 <sup>31</sup> The language of the statute clearly indicates that the legislature intended the named persons to be held  
27 accountable if they have knowledge of the facts of the listed violations, including those which may be the  
28 consequence of poor economic climate, economic circumstances, business decisions, or otherwise.

29 <sup>32</sup> In looking at A.A.C. R20-4-704 it is noted that the Respondent had approximately 8 of 11 factors which  
30 were negative (net worth, tangible, net worth, liquid assets, debt to net worth, outside resources available,  
profitability, projected operating results, and sources of new business). The other factors were not  
affirmatively shown to be positive or negative.

1 reconcilment is not accepted as a violation because the word "adequately" is  
2 a legal and not factual conclusion. Additional allegations in the Report not  
3 specifically addressed during the hearing concern outstanding checks in  
4 excess of 180 days, inadequate follow up on outstanding escrow balances  
5 aged in excess of 180 days and allowing overdraft escrow balances.<sup>34</sup>


### 6 **Recommended Order**

7 It is recommended the Respondent's Escrow Agent's License be revoked

8 It is further Recommended that the Respondent pay a civil penalty in the  
9 amount of Twenty-Thousand and 00/100's (\$20,000.00) Dollars.

10 It is further recommended that Respondent's president Tom Paschen pay  
11 a penalty of Ten Thousand (\$10,000.00) Dollars.

12  
13  
14  
15  
16 Done this day, March 13, 2006.

17  
18   
19 \_\_\_\_\_  
20 Allen Reed  
21 Administrative Law Judge  
22

23 <sup>33</sup> By definition, a missing file is an inadequate record. Other factual assertions include Outstanding  
24 Checks Aged in Excess of 180 Days and Inadequate Follow -Up on Outstanding Escrow Balances Aged  
25 in Excess of 180 Days.

26 <sup>34</sup> Although the Examination Report is *prima facie* evidence, that does not mean the facts stated therein  
27 constitute violations. The legal significance of those facts in light of the applicable law should in some  
28 instances be more specifically addressed with respect to the application of the relevant law.. Terms such  
29 as "reasonable" and "adequate" as used in the Examination Report indicate something other than an  
30 objective or mere factual standard. The quoted words introduce a legal or judgmental standard which  
must be established by something more than mere reference to the facts. Although the Report was  
received as evidence, the ALJ is of the opinion that it is not appropriate to peruse the 37 page Report and  
attempt to match and analyze the multitude of allegations with the cited statutes for the purpose of finding  
a violation. This is more appropriately the function of the Department's counsel. Aside for the obvious  
violations which were determined and the conclusions set forth in paragraph 8, above, no additional  
conclusions are submitted relating to the Report.

1  
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3  
4 Original transmitted by mail this

5 13 day of March, 2006, to:

6  
7  
8  
9 Felicia Rotellini,  
10 Arizona Department of Financial Institutions  
11 ATTN: June Beckwith  
12 2910 North 44th Street, Suite 310  
13 Phoenix, AZ 85018  
14

15 By Chris Fiskledy